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BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of	)	
	)	
AVISTA CORPORATION	)	DOCKET NO. UE-991255
	)	
for Authority to Sell its Interest in the	)	
Coal-Fired Centralia Power Plant	)	
	)	
In the Matter of the Application of	)	
	)	
PACIFICORP	)	DOCKET NO. UE-991262
	)	
for an Order Approving the Sale of its	)	
Interest in (1) the Centralia Steam Electric	)	
Generating Plant, (2) the Rate Based		)
Portion of the Centralia Coal Mine, and	)	
(3) Related Facilities; for a Determination	)	
of the Amount of and the Proper Rate	)	
Making Treatment of the Gain Associated	)	
with the Sale, and for an EWG	)	
Determination		)
	)	
In the Matter of the Application of	)	
	)	
PUGET SOUND ENERGY, INC.	)	DOCKET NO. UE-991409
	)	
for (1) Approval of the Proposed Sale of	)	POST HEARING BRIEF OF
PSE's Share of the Centralia Power Plant	)	AVISTA CORPORATION
and Associated Transmission Facilities,	)	
and (2) Authorization to Amortize Gain	)	
Over a Five-Year Period	)	

____________________________________)

I. INTRODUCTION

In this case, Avista Corporation ("Avista" or "Company") is requesting that the Commission approve the sale of its 15% share of the Centralia Power Plant to TECWA Power, Inc (“TECWA”). TECWA is a Washington corporation and subsidiary of TransAlta Corporation headquartered in Calgary, Alberta, Canada. The sale of Centralia was accomplished through a competitive bidding process with TECWA as the winning bidder.

Avista believes that the record shows that this transaction for the sale of Centralia is in the best interest of the Company and its customers, and that the sale is in the public interest. The Company requests that the Commission approve the sale of the plant, and assign 100% of the gain of the sale to shareholders.

II. THE SALE OF CENTRALIA IS IN THE PUBLIC INTEREST

A. Applicable Legal Authority.

RCW 80.12.020 requires a utility to obtain an order from the Commission to dispose of “the whole or any part of its franchises, property or facilities whatsoever, which are necessary or useful in the performance of its duties to the public.”

In a recent order related to the proposed sale of the Colstrip facilities by Puget Sound Energy, the Commission applied a four part test[1]:

1. The transaction should not harm ratepayers by causing rates or risks to increase, or by causing service quality and reliability to decline, compared with what reasonably

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[1] Third Supplemental Order Approving Sale; Ordering Deferral of Gain and Deferral of Power-Cost Changes, Docket No. UE-990267, In re Puget Sound Energy, Inc., (September, 1999, P. 5-7).

could be expected to occur in the absence of the transaction.

2. The transaction, with conditions required for its approval, should strike a balance between the interest of ratepayers, shareholders, and the broader public which is fair and preserves efficient, reliable, and available service.

3. The transaction, with conditions required for its approval, should not distort, or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service.

4. The jurisdictional effect of the transaction should be consistent with the Commission's role and responsibility to protect the interest of Washington gas and electricity ratepayers.

Avista's proposed sale of Centralia fully complies with each of these standards as explained in Section II.B. and later in Section IV.

B. The "No Harm" Standard.

1. Future Cost of Centralia versus Replacement Power Costs.

The Company's analysis, sponsored by Mr. Johnson, shows that over the 20 year study period, the costs to customers would be lower with the sale, as compared to the continued ownership and operation of the plant. The analysis provided by Mr. Johnson shows, on a present value basis, that customers would save approximately $7.7 million over the 20 year period. (Ex. T-303, p. 4)

There was extensive testimony during this proceeding regarding the future costs of Centralia and the replacement power costs assuming the sale of Centralia. Among the testimony of the parties was the following:

1.1 Forecasts of future market prices were different for each of the three utilities.

1.2 Multiple market price forecast scenarios were presented by Mr. Lazar and his analysis

contained a litany of errors:

a. Mr. Lazar erred in his analysis by using an unreliable market price forecast and later adopting a different market price forecast. (Revised Ex. 501)

b. Mr. Lazar erred in his analysis by shifting the AURORA, Colstrip PSE costs by one year. (Tr. Vol. 4, p. 697)

c. Mr. Lazar erred by omitting a 1 mill/Kwh capacity adder in computing the value of power. (Tr. Vol. 4, p. 749)

1.3 Mr. Buckley testified that in the early years of the AURORA forecast, the market price forecasts are generally too high and should be discounted. (Tr. Vol. 4, pp. 610-11) Mr. Johnson's estimates of projected market energy costs of replacement power range approximately from $26/Mwh to $29/Mwh for the years 2000 to 2005 (See Exhibit 305) compare favorably with Mr. Buckley's estimates of the price he is using in a Bonneville proceeding for a 5-year block of power at $28/Mwh. (Tr. Vol. 4, p. 604)

1.4 Mr. Lazar testified that the sale price for Centralia should be 7.9 times book value, while other sales of generating assets have averaged a much lower 2.18 times book value. (Ex. 317; Ex. T-500, p. 16; Ex. T-314, pp. 5-6) The proposed sale price for Centralia is 3.4 times book value. (Ex. T-314, p. 6)

1.5 Although there was general agreement among the parties that the future ownership and operating costs of Centralia were highly uncertain, Mr. Elgin testified that the costs of Centralia are "fixed known costs" (Tr. Vol. 3, p. 507, L. 17), and later that Centralia is a "known cost resource." (Tr. Vol. 3, p. 531, L. 2)

1.6 Several witnesses testified that the further we forecast out in time, the more uncertainty there is with the estimates. (Johnson Tr. Vol. 2, p. 284, L. 22; p. 285, LL. 19-25) (Weaver Tr. Vol. 4, pp. 684-685) (Elgin Tr. Vol. 3, p. 533)

1.7 With regard to the accuracy of market price forecasts, Mr. Johnson testified that in 1990, BPA forecast the New Resource/Surplus Firm power rate, representing a proxy for the market price of new resources, to be $57.10/Mwh in 2000 rising to $115.90/Mwh in 2011. Actual market/new resource rates are less than one-half that in the year 2000. (Ex. T-314, p. 3) This forecast, made approximately 10 years ago, was off by more than 100%.

1.8 Other parties chose not to engage in the debate as to what the future market prices will be, or what the future ownership and operating costs will be for Centralia. (Wolverton Tr. Vol. 4, p. 482, LL. 21-24) (Hirsch Tr. Vol. 3, p. 482, LL. 19-24)

As is evident from the testimony of the parties in the case, there is a significant amount of uncertainty related to the future market price of power, as well as the future ownership and operating costs of Centralia, especially in the long term. What we do know is that there are significant capital requirements for Centralia for the next five years, which are in excess of $240 million. (Tr. Vol. 4, p. 575, LL. 16-20; Ex. 324) These expenditures, which are approximately equal to the original cost of the plant, are required for the installation of emission control equipment and other capital improvements.

Although various parties offered judgement about which price forecasts presented in this case are reasonable and which are not, the exercise of this judgment is suspect. BPA is one of the largest wholesalers of power in the Northwest. Its price forecast ten years ago was off by over 100%. Even

the most sophisticated model cannot be expected to forecast with any great level of accuracy what the market price of power will be ten years from now. Mr. Lazar testified that only two years ago (1997) his own conclusion related to the future viability of Centralia was "very different" than that included in this case. (Ex. T-500, p. 3)

It is not unusual for different utilities to have different wholesale market price forecasts. This is part of what creates a wholesale market. One party views the market differently than the other and a transaction occurs. There is no way to prove that one market price forecast is better than another, other than to look back after the forecast period has passed. See p. 12 infra.

Mr. Johnson provided an updated price forecast in response to Public Counsel Data Request No. 19. No change in Mr. Johnson's testimony, however, was required. Mr. Johnson's Exhibit No. 305 shows that the costs of owning and operating Centralia will be higher than the replacement power costs through the year 2010. The cost of Centralia will increase significantly in the next few years due to the required investment in emission control equipment and other capital improvements.

Several witnesses have testified in this case that we can have more confidence in the estimates for the next ten years than the estimates beyond ten years. It is beyond this 10-year time frame that the estimates show that keeping Centralia would be less expensive than the replacement power cost. There was a significant amount of discussion related to giving less weight to the estimates that are further out in the future, because of the greater amount of uncertainty for those out years.

Because the estimates show Centralia to be more expensive than the replacement alternatives in the near-term when forecasts are more certain, and less expensive than replacement alternatives

after ten years when forecasts are less certain, giving less weight to the estimates in the years further out would show an even greater benefit to selling Centralia. As Mr. Dukich testified, the discount rate is a financial number to bring a stream of values back to a present value basis. It does not reflect the various uncertainties of events that could occur in the future and the different probabilities of those events. (Tr. Vol. 4, p. 774) As an example, if someone promised to pay you $1,000 today or $100 per year over the next 20 years and your cost of money is 7%, you would discount each of the $100 per year payments at 7% to determine which option is best for you. This calculation assumes that there is an equal probability of receiving the $100 each year, and the discount rate simply reflects the value of the $100 payment to you from year-to-year based on the time value of money. If there is greater uncertainty, however, related to the payments in the last ten years, it would be appropriate to use a higher discount rate for those payments or to make some other adjustment to reflect the lower probability of receiving those payments. Again, if less weight were to be given to the estimates in the out years, or higher discount rate is used to acknowledge the reduced certainty of the savings after ten years, the result would be to show an even greater benefit to selling Centralia.

As stated earlier, Mr. Buckley testified that in the early years of the AURORA forecast, the market price forecasts are generally too high and should be discounted. (Tr. Vol. 4, p. 611, LL. 2-6) Mr. Lazar's suggested sale price represents 7.9 times book value, which is significantly outside the range for sale prices for recently sold power plants, ranging from 0.17 to 5.85 times book value, with an average of 2.18 times. (Ex. 317, Ex. 314, p. 6)

We believe the record supports the Company's analysis of the sale of Centralia as being reasonable and sound. The Company's analysis shows a slight benefit to customers from the sale

of Centralia, a present value of $7.7 million over a 20-year period. This analysis excludes the book gain on the sale, and therefore, the gain represents additional value over and above the no-harm standard.

As to service quality and reliability, the replacement resource options being evaluated by the Company would provide for service quality and reliability at a level equal to that provided by Centralia. (Ex. T-301, p. 6) Thus, the sale of Centralia by the Company is consistent with the first standard related to no harm to customers in all respects.

2. Ownership Structure and Continued Operation of the Plant.

The seven co-owners of the Centralia Power Plant and their ownership shares are as follows: (Ex. T-302, p. 2)

Company	% Ownership	Company	% Ownership
Pacificorp	47.5%	Snohomish PUD	8.0%
Avista Corp	17.5%[2]	Puget Sound Energy	7.0%
City of Seattle	8.0%	Grays Harbor PUD	4.0%
City of Tacoma	8.0%		

PacifiCorp is the sole owner of the Centralia Mine which supplies coal to the Centralia Power Plant under a fuel supply agreement. (Ex. T-302, p. 2)

Continued operation of the Centralia Power Plant requires the installation of sulfur dioxide scrubbers and low nitrogen oxide burners to meet emission standards ordered by the Southwest

[2] On December 31, 1999 Avista purchased Portland General Electric's 2.5% ownership share of Centralia. The 2.5% share will be resold to TECWA along with the Company's 15.0% share. (Tr. Vol. 2, pp. 212-213)

Washington Pollution Control Authority. (Ex. T-301, p. 3) Capital projects at the plant require unanimous approval of all co-owners. Portland General Electric ("PGE"), as well as some other co-owners, did not support the installation of scrubbers at the plant. Closure of the plant, however, would result in mine closure costs, reclamation costs and plant dismantling costs. (Ex. T-301, p. 3) The divergent views of the owners created a difficult situation. The co-owners of the plant agreed that a single owner could more effectively deal with issues pertaining to continued operation of the plant. (Ex. T-301, p. 3) In October 1998 the co-owners put the plant up for sale under an auction process. TECWA was selected as the winning purchaser. (Ex. T-301, p. 3)

The terms of the Centralia Plant Purchase and Sale Agreement required the plant owners to have contracted by the end of May 1999 for the installation of required emission control equipment and to continue the installation of such equipment until the sale closes. PGE wished to avoid investment in the emission control equipment and the risk of not recovering such investment in the event that the sale to TECWA did not close. (Ex. T-301, pp. 3-4) Avista purchased PGE's 2.5% interest in order to enable the sale to TECWA to proceed. Avista will sell the 2.5% share purchased from PGE to TECWA. (Tr. Vol. 2, p. 212, LL. 11-14) Avista also entered into an agreement with Snohomish PUD to purchase their 8% share of the plant, at Snohomish's option, in the event that the sale to TECWA does not close. (Tr. Vol. 2, p. 219, LL. 8-11)

If the sale closes, the Company and its customers will benefit through reduced exposure to mine reclamation costs and by enabling Avista to conduct resource optimization strategies more independently. If the sale does not close, Avista will have aggregated ownership shares by reducing the number of existing owners potentially from eight to six, and streamlining somewhat the decision-

making process at the plant. Either way, Avista is better off than it was before. (Ex. 301, p. 4)

On a broader scale, the planned installation of emission control equipment will place the power plant among the cleanest coal-fired plants in the United States. TECWA will be positioned to continue to employ the majority of the some 675 employees at the plant and mine. The region will retain a valuable 1340-megawatt resource, enough power for a city the size of Seattle. The power plant is strategically located along the Interstate 5 corridor and provides voltage stabilization for the transmission system on the west side of the state. (Ex. 301, p. 5)

Mr. Perks testified that the differences among the eight owners have become more of a problem in recent years, particularly regarding installation of emission controlled equipment. (Ex. T-302, p. 2) Even though Mr. Lazar testified in his opinion there is little cause for concern with regard to the ownership structure for Centralia, he agreed there could be some serious issues in the ability of the owners to come to agreement on capital investment, such as the addition of scrubbers, if the public agencies have a different alternative cost of power to look at than do the non-public agencies. (Tr. Vol. 4, pp. 716-718)

The manner in which the current sale transaction has been structured reflects an absence of unanimity among the ownership, in that the contracts related to installation of the emission control equipment include "out" provisions should the sale to TECWA not occur. (Tr. Vol. 2, p. 258, LL. 8-22) If the sale to TECWA does not occur, there is a very real possibility that the plant could be shut down and the mine closed. (Tr. Vol. 2, p. 248, LL. 7-20)

Termination could result in significant costs to Avista's customers, which could be avoided by a sale. (Tr. Vol. 4, pp. 766-767) PacifiCorp witness Miller testified that studies conducted by

the firm of Pincock, Allen & Holt disclosed that in present value terms, the sooner the mine is shut down and final reclamation takes place, the more expensive it is. (Ex. T-201, pp. 12-13) Even Mr. Lazar agreed that current fund balances are not sufficient to cover reclamation costs of the mine. (Tr. Vol. 4, p. 767, LL. 24-25)

III. DISPOSITION OF THE GAIN ON THE SALE

A. **The Gain is Over and Above the Satisfaction of the No Harm Standard.**

The second test applied by the Commission in the Colstrip Order states that "The transaction, with conditions required for its approval, should strike a balance between the interest of ratepayers, shareholders, and the broader public which is fair and preserves efficient, reliable, and available service."

On page 22 of the Puget Third Supplemental Order which relates to the sale of Colstrip, the Commission stated that:

> If the gain from the Colstrip sale clearly accrued benefits beyond the break-even point, then the Commission would need to determine whether or how to share those benefits between ratepayers and shareholders.

In the case of the sale of Centralia, the book gain on the sale is over and above the "break-even point," and, therefore, a determination needs to be made regarding the disposition of the gain. The gain on the sale of Centralia represents economic value over and above the book value of the asset and the amount rate based. Customers have not been charged a return on this economic value (the gain), nor have they paid depreciation based on this economic value. Any portion of the gain assigned to shareholders, therefore, would not take away from customers any value that they have or are currently receiving. (Ex. T-318, p. 7, LL. 9-13)

On cross-examination Chairwoman Showalter asked Mr. Dukich the following question with regard to the disposition of the gain: "Does it make any difference where in the life of a plant we stand when a transaction takes place?" (Tr. Vol. 3, p. 334) On the same page of the transcript Chairwoman Showalter later made reference to customers paying "more up front but less in the out

years."

Mr. Dukich testified in response that in the case of Centralia, the plant has been in service since 1972, approximately 28 years. Centralia is now at a point where the plant requires major capital investment in order for the plant to continue to operate. To the extent that there may have been a declining cost of the plant over time, the costs have already bottomed out and the costs are now on an upswing. (Tr. Vol. 3, p. 335) Thus, to the extent that customers may have paid more up front for Centralia, they have also experienced the lowest costs of Centralia in the years leading up to the current need for additional major capital investment. This is evidenced by the fact that Avista's original investment in Centralia, when it was first placed in rate base, was approximately $36 million. Now Avista's 15% share of the 1999 five-year capital budget of approximately $240 million is $36 million. (Tr. Vol. 4, p. 575; Ex. 324)

B. Balancing the Interests of Customers and Shareholders.

The Company's proposal related to the disposition of the gain is premised upon balancing the interests of customers and shareholders. In its prefiled testimony, the Company posed an important threshold question: Should the gain from the sales of Avista's utility assets always go to customers? The Company believes the answer to the question is no, for a number of reasons. These reasons are related to the prior decisions of the Commission, the Commissions' existing rules and policies, the rate of return authorized for the Company, the role of the Commission in regulating the Company, and symmetry. All of these will be addressed in detail later.

Customers have been well served by Avista as evidenced by the fact that rates have varied between the lowest and the fifth lowest in the United States over the last 20 years. (Ex. T-306, p.7,

LL. 11-12) Several independent studies have rated Avista's customer service and business operations as outstanding. (Ex. T-306, p. 5, LL. 5-11) Shareholders have clearly not been shielded from significant write-offs related to the acquisition of major generating resources. Before tax write-offs since 1985 have totaled over $96 million. (Ex. T-306, p. 5, L. 18, Ex. 309) Regulated rates of return since 1973 have not unduly enriched shareholders. (Ex. T-306, P. 7, LL. 12-14)

Given the write-offs Avista has taken, and given the historically low rates and high quality service enjoyed by customers, it would be reasonable and equitable in this particular instance to allow the Company to retain 100% of the gain associated with the sale. This result would be consistent with the second standard articulated in the Colstrip Order, and would balance the interests involved without diminishing future customer service or rates.[3] (Ex. T-318, p. 2)

C. Rate of Return Does Not Preclude Assignment of Gain to Shareholders.

Sales of assets such as Centralia are subject to a specific decision of the Commission granting

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[3] One approach to allocating gain on the sale of an asset was outlined in Democratic Central Committee v. Washington Metro. Area Transit Comm., 485 F.2d 786 (D.C. Cir. 1973). On pages 805-806 the court framed the task as follows:

> Investors, we have concluded, are not automatically entitled to gains in value of operating utility properties simply as an incident of the ownership conferred by their investments. And it goes without saying that consumers do not succeed to such gains simply because they are users of the service furnished by the utility. Neither capital investment nor service consumption contributes in any special way to value-growth in utility assets. Rather, the values with which we are concerned have grown simply because of a rising market.
>
> Investors and consumers thus start off on an equal footing, and the disposition of the growth must depend on other factors. We thus reach the dual critical inquiry; identification of the principles which must guide the allocation, as between investors and consumer groups, of appreciation in value of utility assets while in operating status; and application of those principles to transit's situation.

approval of the sale. As stated earlier, with regard to any gains on these sales, the Commission stated on page 22 of its Colstrip Order that:

> If the gain from the Colstrip sale clearly accrued benefits beyond the break-even point, then the Commission would need to determine whether or how to share those benefits between ratepayers and shareholders.

If the rate of return was either implicitly or explicitly established under the assumption that all gains from all sales of assets were to be assigned to customers, then there would be no need for the Commission to pose such a question. It would already be answered. (Ex. T-318, p. 3)

The rate of return established by the Commission for the Company does not, in and of itself, preclude a decision by the Commission to assign all, or a portion, of the gain on Centralia to shareholders. In the past the Commission has issued decisions disallowing recovery of a portion of investments made by the Company in generating facilities. (Ex. T-306, pp. 5-6) In both instances, either a disallowance of investment recovery or an assignment of a gain to shareholders, the decision of the Commission has a direct financial impact on financial statements and shareholders, irrespective of the rate of return authorized by the Commission for the Company. (Ex. T-318, p. 3).

The Commission Staff position is that losses are anticipated in the allowed ROE, but that gains are not and, therefore, should never go to the Company. Staff provides no basis for this argument regarding this lack of symmetry.

Staff cites an order in which the Company was awarded a one-time kicker of 15 basis points over and above the allowed ROE to compensate the Company for WNP-3 risk, and yet maintains that the allowed ROE is always fully compensatory for all risk faced by the Company. (Tr. Vol. 4, pp. 569-570) Staff is completely inconsistent in this regard. If ROE is fully compensatory, why

would a equity kicker even be allowed?

The Commission approved cost of equity in Cause No. U-83-26 points out that, absent a specific adder, the allowed return on equity is a cost of money rate that does not reflect the risk associated with the recovery of the Company's investment in utility plant. In addition, Mr. Elgin makes a statement in his direct testimony on page 22, beginning at line 17, that "Shareholders were compensated for accepting the risk of developing new resources through equity risk premiums." An equity risk premium of 15 basis points, amounting to $45,000 of additional net operating income for only a one-year period, is hardly just compensation for the risk associated with Washington's share of the $58.7 million of write-offs shown on Mr. Dukich's Exhibit No. 309, page 1 of 1. It would take 835 years at this premium level to fully recover the cost of the WNP-3 writeoff ($58.7 million x 64% / $45,000).[4]

Mr.Wolverton argued that all gain should be allocated to ratepayers on the theory that the rate of return on all of the utility's assets constitutes compensation to the investors for the risks associated with Centralia. (Ex. T-600, pp. 15-16; Tr. Vol. 3, p. 473, LL 51-21) However, Mr. Galloway's cross-examination of Mr. Wolverton disclosed the weakness of that proposition. Mr. Wolverton admitted that his clients would not automatically support recovery of future environmental costs, at least with respect to PacifiCorp. (Tr., Vol. 3, p. 461) And, although he testified that investors take into account residual risk in establishing the market price of equities he admitted that this

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4 The 15 basis-point-adder in Cause No. U-83-26 resulted in a one-time increase in the Company's net operating income of approximately $45,000 for less than a one-year period of time. Rates in Cause No. U-83-26 were effective January 28, 1984 until January 19, 1985. (Tr. Vol. 4, pp. 569-571)

Commission did not establish return on equity in Washington by taking into account the residual risks associated with the sale of a utility rate based asset. (Tr. Vol. 3, p. 463) For these reasons, the record does not support an argument that all gain on a single asset should be allocated to ratepayers on the theory that investors are fully compensated for their risks through the rate of return authorized on the totality of the utility's assets.

D. Commission Rules/Policies Do Not Preclude Assignment of Gain to Shareholders.

The Company is not aware of any stated Commission policies or rules that require gains from sales of utility assets to flow exclusively to customers. In fact, as stated earlier in the Commission's order related to the sale of Colstrip by Puget Sound Energy, states as follows:

> If the gain from the Colstrip sale clearly accrued benefits beyond the breakeven point, then the Commission would need to determine whether or how to share those benefits between ratepayers and shareholders.

(Third Supplemental Order, In Re Puget Sound Energy, Inc., Sept. 1999 at page 22)

Therefore, the Commission's rules and policies do not preclude the assignment of all, or a portion, of the gain on the sale of Centralia to shareholders. Commission Staff very clearly stated that allowing gains to go to shareholders is not precluded as a matter of law. (Tr. Vol. 4, p. 577, LL. 8-13)

E. Commission is a Surrogate for Competition.

On rebuttal Mr. Dukich testified that one theory of regulation is that the Commission serves as a substitute or surrogate for competition to ensure that pricing to customers is fair, just and

reasonable, and that service is safe and reliable.[5] The presumed monopoly status of the utility and the corresponding regulation by the Commission, however, does not result in customers owning the utility's assets. From a constitutional perspective, ratepayers pay for only the use of utility assets properly used to provide public service, and they never acquire any legal interest in the property used for their convenience or in funds of the utility. See Board of Public Commissioners v. New York Telephone Company, 271 U.S. 23, 46 S.Ct. 808, 70 L.Ed. 808 (1926).

Commission regulation is primarily economic in the sense that prices are regulated through an analysis of various costs, including capital return. Legal and operational ownership, however, resides with, and is the responsibility of, the utility. It is the Company's decision, in the first instance, to determine whether to acquire or dispose of assets. Many of the Company's decisions, however, are subject to the specific approval of the Commission, including the financial impact on customers from those decisions. In the competitive world, both the gains and losses from investment decisions rest with the business owners. Monopoly status, in and of itself, does not preclude the assignment of both gains and losses to shareholders. As the surrogate for competition, it is the Commission's decision as to how gains and losses are shared between customers and shareholders. (Ex. T-318, p. 6)

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[5] The Company is also subject to other sources of competition in the form of alternate fuel sources, neighboring public utilities (Washington does not have exclusive service territories), and Bonneville Power Administration (BPA). BPA serves as wholesale provider of preference power to public agencies within a statutorily defined region in the Northwest that includes all of Avista's service territories. Avista competes with BPA's public agency preference customers for retail load on the fringes of its service territory. In addition, certain customers, such as federal agencies, have direct rights to purchase from BPA. In 1990 Avista lost the housing load of Fairchild Air Force Base to BPA. All of this competition places pressure on Avista to keep its rates low to meet competition. (Ex. T-306, p. 4)

F. **Symmetry.**

On Page 16, Line 8 of his direct testimony, Mr. Elgin states that, "Indeed, if any of the gain is kept by the utility, shareholders will be provided excessive returns through accretion in the utility's book value." We agree with Mr. Elgin that the Centralia gain assigned to shareholders will result in an increase in book value for the Company. However, it is also true that the Company's book value has been significantly decreased in the past for the investments that were disallowed for recovery by the Commission related to WNP-3, Skagit, and Kettle Falls (Exhibit No. 309). If there is to be symmetry (fairness), it is necessary for there to also be an increase in book value from time to time, along with the decreases that have occurred from the investment disallowances. Therefore, it would be appropriate for there to be an increase in book value associated with the gain on Centralia. To our knowledge there are no Commission orders that state in any way that the allowed return on rate base for the Company is a "No Gains" return. That is, the allowed rate of return has not been characterized as a return that requires the Company to absorb losses associated with the acquisition of assets, but precludes the Company from receiving any gains on the disposition of assets. (Ex. T-318, p. 5)

As the Company stated in direct testimony, the purpose of the Company's testimony regarding the prior disallowances of investment by the Commission is not to complain or to call into question the fairness of those prior decisions. (Ex. T-306, p. 6, LL. 6-20) The Company is simply requesting that the Commission carefully consider the balance of equities between customers and shareholders in its decision regarding the disposition of the gain.

Chairwoman Showalter asked several witnesses questions regarding the ratepayers that may

or may not be there in the future to have the benefit of Centralia, and the possibility of open access and stranded costs and benefits. (Tr. Vol. 3, pp. 337-338) Under cross-examination as well as in his direct and rebuttal testimony, Mr. Dukich spoke to the need for symmetry and balancing the interests of both customers and shareholders. (Tr. Vol. 3, pp. 338-339; Ex. T-306; Ex. T-318) As with other decisions of the Commission, the pluses and minuses need to be balanced to the future. In the present case of Centralia, the plant has been in service 28 years. As stated earlier, Centralia is now at a point where the plant requires major capital investment in order for the plant to continue to operate. To the extent that there may have been a declining costs of the plant over time, the costs have already bottomed out and the costs are now on an upswing. (Tr. Vol. 3, pp. 334-335) Thus, to the extent that customers may have paid more up front for Centralia, they have also experienced the lowest costs of Centralia in the years leading up to the current need for additional major capital investment. (Tr. Vol. 4, pp. 576-577)

G. Disposition of Any Gain Assigned to Customers.

In the event the Commission allocates a portion of the gain from the sale of Centralia to customers, such as under the depreciation method proposed by PacifiCorp, the Company has proposed specific ratemaking treatment related to any customer share of the gain in Mr. McKenzie's direct testimony.

The Company has proposed that any customer share of the gain first be used to offset all or a portion of the costs related to storm damages resulting from Ice Storm 1996. Then, if any customer gain remains, the remaining gain be used to offset a portion of the transition obligation for post-retirement health care and life insurance benefits. If the Commission adopts the Company's

proposal, both items identified above would have the effect of reducing the revenue requirement in the Company's general electric rate case, Docket No. UE-991606, as well as reducing the revenue requirement in the future.

IV. COMPLIANCE WITH TESTS THREE AND FOUR OF THE COMMISSIONS FOUR PART TEST

With regard to the third of the Commission's four part test related to the sale of Centralia, Mr. Ely testified in his Direct Testimony that the Company believes the sale of Centralia would not "distort or impair the development of competitive markets," and would not have a negative impact on the availability or deliverability of affordable, reliable electric service to the Company's customers. (Ex. T-301, pp. 7-8)

With regard to the Commission's fourth test, Mr. Ely testified that the sale of Centralia would not diminish in any way the "Commission's role and responsibility to protect the interests of Washington gas and electric ratepayers." (Ex. T-301, pp. 7-8)

To the Company's knowledge, no party in the case took the position that the sale of Centralia did not comply with the third and fourth tests of the Commission's four part test.

V. OTHER ISSUES

A. The Commission Should Not Impose Additional Conditions Upon the Sale.

Witness Hirsch, proposes that the Commission impose certain environmental related conditions upon the use of the proceeds from the sale of the Centralia Power Plant by the owning companies. (Ex. T-701, pp.5, 10-11) Such recommendations are inappropriate and wrongly assumes that the Commission has statutory authority to mandate a company’s future investments and expenditures. Avista knows of no statutory authority so authorizing the Commission.

Mr. Lazar also recommends that if the sale is approved, the Commission take specific steps to ensure that ratepayers are held harmless, including a requirement that selling utilities continue to sell customers power at a price no higher than if Centralia were not sold. (Ex. T-500, p. 3) This would be an unfair and asymmetrical condition to impose, in as much as no rate of return is guaranteed to the selling companies, if they retain ownership of Centralia. The record amply

demonstrates benefits sufficient to Avista's ratepayers to justify the approval of the sale without further conditions.

B. Disposition of the Gain May Appropriately be Different for Each Utility.

Mr. Dukich testified on rebuttal that although the Commission is obviously not precluded from ordering similar treatment of the gain for the three utilities, the Commission in the past has avoided a "one size fits all" approach to regulation. (Ex. T-318, p. 9) Mr. Dukich provided an example of how the investment recovery provided by the Commission related to WNP-3 was different for Avista and Puget Sound Energy. (Ex. T-318, p. 9) Both companies had invested in the same generating project, but received different cost recovery treatment. In this case, it may be appropriate for differing treatment of the disposition of the gain for each utility, based on the unique circumstances of each utility. Avista's unique circumstances were outlined in Mr. Dukich's direct testimony. (Ex. T-318, p. 9)

C. Gain on the Sale of Washington Irrigation & Development Company (WIDCO).

The list of electric investment write-offs totaling $58.7 million after tax shown on Mr. Dukich's Exhibit No. 309, page 1 of 1, relate only to utility investments. On cross-examination Mr. Adams asked Mr. Ely whether Avista sought approval from the Commission to sell its one-half interest in the Centralia coal mining properties held by the Washington Irrigation & Development Company (WIDCO) a wholly-owned subsidiary of Avista Corporation (Washington Water Power at that time). Mr. Ely was also asked whether Avista retained the gain associated with the sale. (Tr. Vol. 2, p. 223)

WIDCO was separately accounted for as a non-regulated subsidiary of Avista and WIDCO's assets were never included in Avista's rate base. (Tr. Vol. 2, p. 250) Since WIDCO was a non-utility operation, it was not necessary to obtain regulatory approval to sell the mine and the entire after tax

gain on the sale of approximately $13.5 million was retained by shareholders.

D. <u>Disposition of Gains Related to Prior Asset Sales.</u>

On page 4 of Mr. Martin's direct testimony, he discusses a prior decision of the Commission related to gains on sales of property in a Puget Sound Energy case. We believe it can be helpful to look at prior decisions of the Commission, if the issues and circumstances in the case are such that a direct application can be made to the current case. The case referred to by Mr. Martin, however, involved multiple sales of non-depreciable real property by Puget Sound Power & Light during the period 1974 to 1989 (Docket U-89-2688-T). We do not believe that the issues and circumstances in that case support a similar decision in this case, or in any way binds the Commission to a similar decision, especially since that case involved a stipulation. (Ex. T-318, p. 10)

The Stipulation in Docket U-89-2688-T clearly states that the gains at issue in the case were related solely to sales of non-depreciable real property. In the case of Centralia, the gain is related to the sale of a major base-load generating resource. The Company's investments in generating resources have been subjected to rigorous reviews that have resulted in substantial write-offs for the Company. The Company believes a decision related to the disposition of the gain on the sale of Centralia is clearly in a different category than that of the relatively minor real property transactions. (Ex. T-318, pp. 10-11)

In addition, on page 4 of Mr. Martin's Direct Testimony, he discusses the disposition of a gain on the sale of a combustion turbine generator by the Company. In 1987 the Company sold its Othello combustion turbine generator and realized an after-tax gain of $143,000 applicable to the Washington jurisdiction. In its order approving the sale in Docket No. 87-1533-AT, the Commission

ordered the Company to defer the gain in a deferred credit account until final disposition of the gain was determined in the Company's next general rate case.

In a <u>stipulation</u> filed with the Commission in 1990 (Docket No. UE-900093) the Company and Commission Staff reached agreement to apply $84,000 of the gain to offset Company write-offs related to Othello turbine fuel and Shawnee transmission materials. The remaining $59,000 of the gain was included as a rate base reduction in the calculation of the Company's revenue requirement in Docket No. UE-900093. The gain on the sale of Othello involved a stipulation and was obviously relatively immaterial, and in our opinion should not be considered precedent setting. (Ex. T-318, p. 11)

E. <u>Original Cost Calculations.</u>

In response to questions from Commissioner Hemstad, Mr. Lazar explained a method of sharing the gain by subtracting the original cost of the plant of approximately $57 million from the sale price of $67 million for a "real gain" of $10 million. According to Mr. Lazar, after you make the shareholder whole for the undepreciated book value of $17 million and make the ratepayers whole for $40 million of depreciated book value, then all the Commission needs to do is decide how to divide up the "real gain" of $10 million in some equitable fashion. (Tr. Vol. 4, pp. 746-747) Mr. Lazar's proposal is incorrect from both a theoretical basis and from an accounting basis. Customers do not own a share of the Centralia Power Plant. When an apartment owner sells an apartment building, the owner does not share the gain on the sale with the former tenants of the building. Mr. Lazar's "real gain" does not exist from an accounting standpoint. The estimated after-tax gain on the sale of the plant of $29.6 million is set forth in Mr. McKenzie's Exhibit 312, p. 1 of 3. This theory

might apply to a customer selling his or her personal residence which has never been depreciated, but it certainly does not apply to utility property that has been depreciated for both book and tax purposes.

VI. CONCLUSION

In this case the Company is requesting that the Commission approve the sale of its share of the Centralia Power Plant. The sale of Centralia was accomplished through a competitive bidding process with TECWA as the winning bidder. The Company's decision to sell the plant took into consideration both the quantitative and qualitative factors surrounding continued ownership of the plant, versus the sale of the plant at the price offered by the buyer, together with the projected replacement power costs. The Company's decision to sell, especially with regard to the qualitative factors, also involved business judgement.

Avista believes that the record shows that this transaction for the sale of Centralia is in the best interest of the Company and its customers, and that the sale is in the public interest. The Company believes the record shows that the sale of the Plant and proposed disposition of the gain fully complies with each of the four tests adopted by the Commission in evaluating the sale of property such as Centralia. The Company requests that the Commission approve the sale of the plant, and assign 100% of the gain on the sale to shareholders.

DATED this 27th day of January 2000.

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